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C O N F I D E N T I A L SECTION 01 OF 02 TRIPOLI 000358

DEPARTMENT FOR NEA/MAG LONDON FOR TSOU

E.O. 12958: DECL: 7/23/2016 TAGS: ECIN ECON PGOV LY SUBJECT: LIBYAN PROSPECTS FOR BANKING PRIVITIZATION - TOUGH ROAD AHEAD

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CLASSIFIED BY: Greg Berry, Chief of Mission, USLO Tripoli, REASON: 1.4 (b), (d)

11. (C) Embassy has spent several months developing a working relationship with a Libyan banker who returned to Tripoli six months ago to manage the office of a correspondent bank. As a representative office, he chases large business deals and then books the loans in London. He was educated and worked in Britain for a number of years before agreeing to return to Libya and has offered his insights about banking operations both in Tripoli and outlying cities.

FEW PROSPECTS FOR FOREIGN BANK PARTICIPATION IN LIBYA

12. (C) "No one in their right mind would try to enter the Libyan market under the current restrictions," was the assessment of the bank officer manager. Banks in Libya are simply custodians of salary payments; they are not able to fulfill most of the banking services. For example, a bank earns only 1.75% per annum on funds placed at the Central Bank. The interest doesn't even cover the expense of bank operations given the bloated employment rolls. He estimated that more than 8000 families relied on salary payments from the commercial banks. In the case of Sahara Bank, it might currently have 3000 employees, but if run efficiently by professional managers, could operate with fewer than 1000 staff members. Queried about the Secretary of the General People's Committee for Finance (Finance Minister) position that foreign bank participation had to be delayed unless there were assurances the branches in remote locations of Libya would remain open, the banker responded, "what is the point of keeping those branches open when no services are offered? People would be better off buying gold that might appreciate in value since they earn so little interest on deposits. Money might as well be stuffed under the mattress." Regarding the sale of the Sahara Bank underway for a year, he said that at 10 dinars per share, the price was overstated and not a good value.

BANKING SUPERVISION LAGS IN PRACTICE

13. (C) Asked about anti-money laundering efforts in Libya, he said that banks were required to submit regular reports to their head offices, which in turn reported to the Central Bank. The weak link in the chain was implementation by poorly trained and poorly paid staff. While the international community has been developing standards and procedures, Libya has been trapped in the past and required total regeneration. He estimated the banking sector is at least 30 years behind. In his view, the effectiveness of attempts to freeze suspect accounts would always be hampered by innate problems with names, spellings and birthdates in the Arabic speaking world. He also believed that, despite the new AML law, there were still not enough safeguards in the system. He noted the ease of evading a blocking order through slight variations in the names on an account or through tip-offs from bank staff. Many bank personnel were very uncomfortable with the idea of reporting on clients.

14. (C) In terms of informal money exchange, he said that the gold souk was the best form of hawala and also the most accurate predictor of exchange rate levels. People used the gold merchants to transfer money out of Libya for both legitimate and illegitimate transactions. In general, Libyans prefer to "avoid the eyes of the government" and make informal payments whenever possible. He stressed the importance of not attracting attention to oneself - inevitably someone else decides they deserve a cut of the action or can set up a competing enterprise.

-----CONTRADICTORY, COMPLICATED POLICIES

15. (C) The Libyan government tried last year to inject more liquidity into the economy by reducing the interest rate on money banks deposited at the Central Bank to 1.75%. The Government hoped that the lower rates would force banks to offer more attractive financing to private businesses and thereby encourage private sector development. However, at the same time, the Central Bank required that private businesses pledge collateral worth 125% of the loan's face value in order to secure a loan. The collateral rule is extremely difficult for

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most borrowers to meet. As an example, he cited a company that had acquired land worth \$2 million dinars and imported millions of dinars worth of equipment, but the Libyan banks refused to provide any loans to expand and develop the business because of the 125 percent collateral rule, combined with many other regulatory burders regulatory burdens.

16. (C) In his estimation, Libyans don't take risk because they don't trust the government. There have been too many cases of favoritism in business deals and government rulings. He said, "the Bedouin mentality is still very strong. The tribal system predominates. Family ties and connections are a primary consideration in every decision. Deep seated priorities are

access to water and livestock survival - there are parallels to access to water and livestock survival - there are parallels to modern business decisions." In addition, there is a deep seated distrust of the government and the reform effort. People know that the reform effort is being "managed" by Saif al-Islam and don't think that it will bring any real benefit to the public. They want assurances that their government salaries and subsidized goods and services will continue indefinitely. They have a tremendous sense of entitlement and deep seated belief that the government owes them a regular salary for minimal work. He also described that he sees as deep-seated resentment towards Libya's neighbors, especially Egypt and Tunisia. Libyans were forced to travel during sanctions and had bad experiences with border crossings, customs formalities. They felt disrespect from their neighbors and humiliation. There was particular resentment of smuggling rings that profited from Libya's isolation.

CREATIVE CASH TRANSFER BY LAUNCHING SUBSIDIZED TRACTORS

17. (C) In terms of smuggling, though, the Libyans seem equally creative at finding ways to get items across borders. At one point, the Libyan government was attempting to encourage agricultural production by giving subsidized tractors to farmers. The resourceful farmers made deals with smuggling rings on the other side of the border to take possession of the tractors in return for cash payments. In order to make the exchange without going through customs controls, the farmers would take the subsidized tractors with a full tank of subsidized petrol to a remote field, rig the machine so it would continue for miles in a straight line, and then launch the unmanned equipment in the direction of the border. The conspirators on the other side would eventually recover the tractor somewhere in Tunisia or Egypt and deliver cash back later. In the unlikely event a roving border patrol encountered the unmanned tractor, everyone involved had some degree of deniability: "I lost my tractor."

HOPE IS ON THE HORIZON

- 18. (C) A McKinsey employee stopped by the Embassy to inform us that they have been hired by an individual, "who can not be named," to prepare a comprehensive strategy for implementing bank privatization in Libya. McKinsey planned to spend a week interviewing all the Libyan bank officials, both state and private, then return to Tripoli in several weeks for a second round of meetings after the initial assessment. McKinsey's mandate is to come up with a plan that can get foreign banks into Libya in the near term, while at the same time formulating a plan for dealing with the state banks and their unwieldy payrolls of public employees as well as their nonperforming loans.
- 19. (C) Embassy Comment. It is just another example of the "state of the masses" that the Jamahiriya is not able to reach consensus within its many committee structures to move forward with a banking privatization plan on its own, or even to reach consensus to hire experts to make recommendations. Similar to the National Economic Strategy funded by Saif al-Islam, launched with great acclaim, but still without any activity associated with it, the challenge will be getting the McKinsey bank privatization plans actually implemented. privatization plans actually implemented. BERRY